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RUEHVC

DE RUEHBU #1389/01 2831713

ZNR UUUUU ZZH

O 091713Z OCT 08 ZDK

FM AMEMBASSY BUENOS AIRES

TO RUEHC/SECSTATE WASHDC IMMEDIATE 2200

INFO RUEATRS/DEPT OF TREASURY WASHINGTON DC IMMEDIATE

RUCPDOC/USDOC WASHINGTON DC IMMEDIATE

RHMFIU/HQ USSOUTHCOM MIAMI FL IMMEDIATE

RUCNMRC/WESTERN HEMISPHERIC AFFAIRS DIPL POSTS IMMEDIATE

RUEAIIA/CIA WASHINGTON DC IMMEDIATE

RHEHNSC/NSC WASHINGTON DC IMMEDIATE

RUEKJCS/SECDEF WASHINGTON DC IMMEDIATE

UNCLAS SECTION 01 OF 04 BUENOS AIRES 001389

SENSITIVE

SIPDIS

Ref: A) BUENOS AIRES 1374, B) BUENOS AIRES 1312, C) BUENOS AIRES 1277

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [ETRD](#) [PREL](#) [PGOV](#) [AR](#)

SUBJECT: Argentine Congress' Budget Review Clouded by Global Uncertainty

Summary

¶11. (SBU) The Argentine legislature is set to amend the 2008 budget and pass the 2009 budget in the face of a deteriorating external environment and increasing anxiety about its impact on Argentina's economy and finances. The 2008 bill increases expenditures in 2008 by about US\$11.5 billion due to higher than expected revenues, and also amends the Central Bank Charter to allow use of reserves to pay the Paris Club. Although GoA presentation of both bills was more open and transparent than in previous years, the 2009 budget continues the GoA practice of lowballing economic assumptions for GDP growth (4%) and inflation (8%), both below most private estimates. However, the gap between the budget assumptions and reality may well be much smaller this year, as we expect analysts to continue marking down expectations for 2009 growth due to fallout from the financial crisis. The 2009 budget also includes assumptions for a primary fiscal surplus of 3.27% of GDP and a trade surplus of US\$12 billion that appear optimistic in light of decelerating growth, the dramatic fall in commodity prices, and slowing world demand. The opposition has criticized GoA budget decisions to retain emergency powers to realign spending at will and expand its ability to borrow from government-owned Banco Nacion and the Central Bank. These moves could prove useful to the GoA in possibly dark economic days ahead. It appears likely, however, that the GoA will face tough 2009 mid-term elections with tighter finances and less leeway to use spending to win political support.
End Summary.

Global Uncertainty Looms Over Budget Vote

¶12. (SBU) In the context of the global financial crisis, high volatility and increasing uncertainty in Argentine markets, and predictions of a sharp world economic slowdown, the Argentine legislature is set to act next week on two key budget laws that will direct the GoA's fiscal policies during the turbulent period to come: amendment of the 2008 budget and passage of the 2009 budget. Ruling party Senator Luis Alberto Viana, Chairman of the Senate's important economic and investment committee, reassured Ambassador October 2 that the legislature will accept the amended 2008 budget and rapidly pass the 2009 bill without major changes. However, it is clear that the difficult external environment is causing increasing anxiety in both Congress and the GoA (see Ref A) with regards to the fallout on Argentine economic growth and GoA finances.

2008 Budget Amendment: funding for subsidies/Paris Club

¶13. (SBU) President Cristina Fernandez de Kirchner (CFK) signed on September 15 her first ever "Urgent Necessity Decree" (DNU), amending the 2008 budget to increase expenditures by 36 billion pesos (or roughly US\$11.5 billion). The estimate for expenditures in the original 2008 budget was 161 billion pesos (about US\$51 billion). The GoA will finance the expenditures from higher than expected revenues, the result of the GoA's underestimation of both growth and inflation in the original 2008 budget bill. Also a common budget practice during Nestor Kirchner's Presidency, the GoA underestimated 2008 growth at 4%, compared to private estimates of 7%, and CPI inflation at 7.3%, when most analysts expect inflation to end the year at about 20%.

¶14. (SBU) The GoA has announced it will direct these additional revenues to cover higher than expected expenditures in 2008 for transport, energy and food subsidies. CFK likely used the DNU because it is faster than drafting legislation, is the equivalent of law, and goes into effect after approval in a special bicameral committee. (In theory, both the Chamber of Deputies and Senate must then submit the DNU to floor vote, but in practice this usually happens months later with no debate.)

¶15. (SBU) Senator Viana told Ambassador that Congress would treat this DNU as a full law and approve it through floor votes. However, he conceded that Argentina needs to get away from using DNUs, which made more sense following the 2001/02 crisis when the country was in disarray and the GoA needed to act quickly. CFK has boasted in the past that she has not issued one DNU since entering office, whereas

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the opposition severely criticized her husband Nestor Kirchner for relying heavily on them during his presidency.

¶16. (SBU) The 2008 budget amendment includes an understated article amending the Central Bank (BCRA) Charter to allow use of official reserves to pay the Paris Club (reported reftel). The article establishes an exemption to the BCRA prohibition on long-term lending to the GoA. The exemption will allow the BCRA to issue a loan to the GoA for the purpose of paying public debts as specified under the decree issued September 3, 2008, declaring the GoA's intention to pay 100% of debts owed to Paris Club creditors. By including it as a minor article in an eighteen-article DNU, the GoA kept press attention to a minimum.

Greater Transparency in unveiling of 2009 Budget

¶17. (SBU) Also on September 15, President CFK signed the 2009 Budget Bill and sent it to Congress for approval. As evidence of the GoA's willingness to show greater transparency and openness under new Cabinet Chief Sergio Massa, Economy Minister Carlos Fernandez, Finance Secretary Hernan Lorenzino, and Massa himself all participated in lengthy presentations on aspects of the budget and submitted to detailed question and answer sessions with both Congress and the press. In contrast, former Economy Minister Miguel Peirano refused to entertain any questions after presenting the 2008 budget bill in October 2007.

2009 Budget Highlights: lowball assumptions may turn out to be overly optimistic

¶18. (SBU) The 2009 bill continues the previous government's trademark practice of underestimating key economic assumptions in order to benefit later from having higher than expected revenues. However, given the deteriorating global economic climate and also most private analysts' estimates of rapidly decelerating economic activity in Argentina, many of the following estimates may prove accurate or even optimistic.

-- The bill estimates GDP growth in 2009 of 4%, conservative compared to BCRA consensus survey estimates of 5.4%. However, this prediction is in line with many of the more conservative private estimates, and exceeds Citi's latest pessimistic predictions of 2-3% GDP growth.

-- 2009 CPI is estimated at 8%, well below private estimates of 20% or higher for 2009. Independent economic analysts have interpreted the GoA's budgeted CPI as an indication that the GoA will continue to "intervene" in national statistics agency INDEC's inflation calculations well into 2009.

-- An average exchange rate of 3.19 ARP/USD. (The private sector expects greater depreciation of the currency, with the BCRA consensus estimate for 2009 at 3.35 ARP/USD, and some private analysts recently predicting 3.5 ARP/USD.)

-- Primary fiscal surplus of 3.27% of GDP, compared to the primary surplus of 3.15% of GDP included in the 2008 budget. (Due to higher revenue growth than expected and slower growth rate of expenditures, some economists have predicted the GoA could end 2008 with a 3.5%/GDP primary surplus. However, the 2009 estimate looks optimistic giving rapidly decelerating economic activity and falling commodity prices.)

-- A trade surplus of US\$11.9 billion, as a result of exports for US\$78 billion and imports for US\$66 billion. The trade surplus in 2007 was US\$11.2 billion and it is estimated at US\$10.6 billion for 2008. However, private estimates of the trade surplus in 2009 are sharply lower, at US\$8.2 billion, reflecting rapid increases in imports and falling commodity prices.

-- A three billion peso reduction in GoA subsidy payments, primarily to the energy and transportation sectors, equivalent to an almost a 10% drop from 2008 subsidies estimated at 35 billion pesos (about US\$11 billion).

-- An estimated 25% increase in public pension payments, representing an increase in expenditures of about 10 billion pesos.

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(This follows from the Pensioners Mobility Law, ordered by the Supreme Court and pending approval in Congress.)

-- A new appropriation of 600 million pesos per year (about 50 million pesos per month) to cover operational expenditures of the recently nationalized airlines Aerolineas and Austral (Ref B). Private estimates of the funding necessary to keep the airlines afloat are three times higher.

GoA retains superpower authority

19. (SBU) Contrary to media speculation that the GoA might use the 2009 Budget bill to end its reliance on the so-called "Superpowers" Act, the draft sent to Congress retains it. These "superpowers" gives the Chief of Cabinet broad discretion to redistribute spending without prior Congressional approval. In previous years, the underestimation of growth and inflation has resulted in significant levels of excess revenues. Opposition Deputy Claudio Lozano estimates that from 2003 to 2008 the GoA managed about 85 billion pesos (roughly US\$27 billion) without Congressional oversight. Lozano predicts that the GoA will have an additional 15 billion pesos in excess revenue to spend in 2009, though this will not be the case if growth decelerates more rapidly than the GoA expects, as many private economists now anticipate.

GoA expands access to Banco Nacion and BCRA funds

110. (SBU) The 2009 Budget bill includes two controversial articles increasing the GoA's ability to borrow from the largest Argentine bank, state-owned Banco de la Nacion (BNA) and also from the BCRA. The bill changes the BCRA's Charter to allow it to provide

short-term lending for the GoA to use for any foreign currency payments, whereas before these funds could only be used to debts to international financial institutions. This means that the GoA could use BCRA funds to pay sovereign debt obligations coming due in 2009, which are estimated much higher than in previous years. The bill amends BNA's Charter to allow the GoA to borrow funds to finance capital expenditures and debt repayments up to a limit of 30% of the GoA deposits held at the BNA. This type of financing is currently prohibited under the BNA's Charter. The opposition has criticized both initiatives, arguing that they undermine the independence and potentially the strength of the two financial institutions' balance sheets, and is vowing to fight to excise the provisions from the bill. (Comment: While these are questionable moves, the greater access to BCRA and BNA financing may prove highly useful to the GoA in the event that the global economic downturn and consequent economic deceleration in Argentina prove sharper than expected. End Comment.)

Comment

¶11. (SBU) Since CFK submitted both budget bills to Congress, Argentina's stock market has plunged 11%, Argentine country risk has jumped over 400 basis points to a post-crisis record of 1232 bps, 10-year sovereign bond yields have increased on average to 23% (from 17%), the Peso has depreciated 4% from 3.07 ARP/USD to 3.23, prices for Argentina's main agricultural and hydrocarbon commodity exports have fallen 25-30%, and the banking system is seeing early signs of dollarization of deposits and capital flight. There were already concerns about the impact of the financial crisis on Argentina, and the news of the last three weeks has exacerbated these concerns. CFK and other GoA officials have touted Argentina's twin surpluses (trade and fiscal) and high reserve levels as an umbrella protecting Argentina against external shocks. However, private analysts are rapidly ratcheting down their estimates for Argentine growth, exports, and fiscal balance.

¶12. (SBU) For the first time under the Kirchners, the assumptions in the budget that Congress passes over the next few weeks will likely turn out to be overly optimistic. With important interim congressional elections set for 2009, this could prove an uncomfortable check for a government hoping to use excess revenues for purposes of political patronage, as it has in recent elections.

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